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Financial Markets

Irving Trust

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The credit markets are beginning to refocus on rate fluctuations in a more normal trading range. But the big story is still the immensity of the rate decline that has occurred in the past two months. Short-term money market rates have already declined 1,000 basis points, a return to their levels prior to November 1, 1978, when the Federal Reserve raised the discount rate 1% as part of a series of dollar defense measures. Looked at another way, short-term rates have already declined 80% of the way to the lows that we have been expecting for this cycle.

A drop that far that fast has naturally caused expectation of a technical reversal. But no significant backup in rates has materialized. Nor is it likely to occur before the recession is perceived to be over. Until then, any reversal will probably be limited to 100 or 150 basis points and not last very long. Rate movements are soon going to be a good deal less volatile than we have come to expect over the past few months. Before long, changes of 25 or 50 basis points will probably be receiving the attention recently given to moves of 100 basis points or more. Rates clearly can't continue sliding at the pace they have been. If they did, bankers would soon be paying their customers to take out loans. And if no significant rate backup is possible while signs of the recession multiply, this means a more normal trading range is going to have to develop around a much more modest downtrend over the remainder of this cycle.

Long-term rates have so far declined 250 or 300 basis points. Relatively, this represents a significantly smaller decline than for short rates. Whereas short rates are already back to their level of 1978, long rates are only back to their level at the beginning of this year, having declined only 50% of the way to the lows that we expect for this cycle. This relatively modest decline in long rates is not surprising, however, since the current difference between the declines in long- and short-term rates typically occurs in the early stages of a down cycle, as corporations refund short-term borrowings in the long-term markets. The record volumes of new corporate offerings that have recently been coming to market have put downward pressure on short rates and upward pressure on long rates.

Predicting a peak in business activity is usually a good guide as to when a cyclical peak in interest rates will occur. And that certainly proved to be the case this time. But predicting when business activity will bottom out is not as reliable a guide with respect to forecasting an interest rate trough. In the last cycle, the rate trough occurred almost three years after the recession ended; and in the cycle before that, the rate trough was more than a year after economic activity turned up. Rates did back up in both of the last two cycles soon after the end of the recession, but they later subsided and fell to their cyclical lows. Much the same may happen this time.

Gordon B. Pye

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Market Yields

	5/30/80	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	(noon)		
Short-term loans to substantial depositors	14.00%	14.50%	11.75%
with highest credit rating	5/30/80		
Effective since			
Discount Rate at Federal Reserve Bank	12.00	13.00	9.50
Federal Funds	11.00	8.75	10.25
Repurchase Agreements	8.25	8.25	10.00
U.S. Treasury Issues			
Bills			
3 months	8.20	7.85	9.93
6 months	8.55	8.20	10.02
1 year	8.90	8.45	9.93
Coupons			
2 years	9.15	8.65	9.54
4 years	9.70	9.35	9.05
7 years	9.95	9.68	9.03
10 years	10.20	9.80	9.07
Long Bond	10.30	10.08	9.08
Negotiable Certificates of Deposit-Secordary Market			
1 month	8.65	8.45	10.10
3 months	8.75	8.50	10.12
6 months	9.05	8.40	10.22
1 year	9.00	9.00	10.30
Banker's Acceptances			
1 month	8.60	8.10	9.98
3 months	8.70	8.15	10.10
6 months	9.10	8.35	10.23
Eurodollar Deposits			
1 month	9.50	8.94	10.31
2 months	9.75	9.25	10.44
3 months	9.88	9.50	10.56
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.00	4.00	6.00
1 month	8.00	8.00	9.88
3 months	7.75	8.00	9.75
Bank Holding Companies			
1 month	8.38	8.25	9.95
Dealer Placed:			
3 months	8.38	8.25	9.95
New AA Corporate Utility Bond	12.00	11.50	9.95
Tax Exempt			
6 month Project Notes	5.05	4.90	4.65
1 year AAA Bond	5.20	5.00	N/A
5 year AAA Bond	5.55	5.20	N/A
20 year AAA Bond	6.75	6.75	5.70

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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